

This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 03 PRETORIA 003233

SIPDIS

Sensitive

STATE PLEASE PASS USAID  
STATE PLEASE PASS USGS  
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND  
DOE FOR THOMAS SPERL

E.O. 12958: N/A  
TAGS: [EPET](#) [ENRG](#) [EINV](#) [EIND](#) [ETRD](#) [ECON](#) [SF](#)  
SUBJECT: SOUTH AFRICA: REGIONAL ELECTRICITY DISTRIBUTOR  
ESTABLISHED, BUT FRAUGHT WITH QUESTIONS

#### Summary

-----  
[1](#)1. (U) On July 4, the government launched the country's first regional electricity distributor (RED) - known as RED ONE. For the moment, RED ONE encompasses only Cape Town and a few nearby municipalities in the Western Cape, but the plan is for up to 40 municipalities to voluntarily join. RED ONE is part of a much broader plan to create six regional distributors that will be able to provide local electricity service more efficiently than 187 municipalities do now. However, serious legal, commercial, and operational hurdles must be resolved before the REDS plan can be implemented. The government is determined that restructuring take place, and has promised to apply greater political pressure and amend municipal law, if need be. The Electricity Regulation Bill, due in Parliament at the end of August, may be the first opportunity to resolve some of the legal and operational issues. End Summary.

#### BIG RED

-----  
[1](#)2. (U) On July 4, Minister of Minerals and Energy Lindiwe Hendricks launched in Cape Town what the government billed as the first regional electricity distributor (RED ONE). Actual operations began on July 1. The timing of the launch met the July 1 deadline that President Mbeki put forward in his opening speech to Parliament last February. RED ONE is the first step of a plan to create six regional distributors by 2007 to manage the supply of electricity to end users throughout the country.

[1](#)3. (U) At the launch, Phindile Nzimande, CEO of Electricity Distribution Industry Holdings, Inc. (EDI, a government corporation established to facilitate the creation of regional distributors) said that restructuring along regional lines should raise the efficiency, quality, and affordability of electricity for everyone in South Africa. As larger entities, the REDs should be able to reach economies of scale, be better able to build and maintain infrastructure, and harmonize the 150 plus tariffs that are currently charged across the country.

[1](#)4. (U) RED ONE will be managed by a Chief Executive Officer and a Chief Operating Officer who will report to a 15-person board. Appointed as first CEO is former Cape Town Council member Saleem Mowzer. Appointed as first COO is former Eskom Western Region General Manager Peter Sechemane. Phindile Nzimande was appointed Chairperson of the Board. As CEO of EDI, she also reports directly to Minister of Minerals and Energy Lindiwe Hendricks. Six other board members have also been named.

#### OR LITTLE RED?

-----  
[1](#)5. (SBU) Despite the hoopla of the launch, the truth is that nothing much has changed from an operational point of view. RED ONE comprises only the Cape Town Metropolitan area, already an active municipal electricity distributor before it became RED ONE. What has changed, however, is that, legally, the Cape Town Municipality now functions as a RED. Some forty other municipalities throughout the Western Cape Province and the western section of the Northern Cape Province may now voluntarily join RED ONE. For this to start happening, however, quite a few issues still need to be resolved. Still under negotiation is compensation for and transfer of assets and liabilities to RED ONE, shareholding in RED ONE, revenue sharing by participating municipalities, as well as various governance and competition issues. Moreover, there is still a debate over what type of legal entity RED ONE should be, i.e., a public enterprise or a municipality.

[1](#)6. (SBU) Tom Skinner, Eskom's Project Manager for Distribution Restructuring, believes that RED ONE

negotiations with Eskom will take at least six to eighteen months to complete, and that incorporation of all regional municipalities will take at least three to five years to complete. In the meantime, Eskom has agreed to supply RED ONE with electricity for 18 months in lieu of its commitment to the Cape Town Metropolitan area.

#### A Constitutional Matter?

17. (U) The reason for all of the delay and extended negotiations is that the establishment of regional electricity distributors (REDs) flies in the face of the South African Constitution, which delegates the delivery of electricity to municipal government. Section 156 states that only municipalities have the authority to administer "electricity and gas reticulation, and street lighting." Reticulation is defined as the distribution of electricity at 380 volts or less. This means that, short of amending the constitution, authorities have just two options for establishing a RED: i.e., build a RED on top of an existing municipal entity; or declare a RED to be a municipal entity. One way or the other, it is for the municipalities to decide whether to join.

#### The Municipal Problem

18. (SBU) Currently, some 187 municipalities out of a total 284 distribute electricity at 380 volts or less to their own and sometimes neighboring municipalities. Government estimates indicate that 50% of these municipalities would probably not be economically viable if revenues from their electricity services were withdrawn. Because of this, many municipalities have been very reluctant to accept the idea of relinquishing their electricity distribution services to a RED, despite of government assurances of compensation. Even the National Treasury worries that municipalities without electricity revenues would saddle the national government with bankrupt municipalities.

19. (SBU) In the meantime, municipalities seem to be making a mess of electricity distribution. Knowing that regional electricity distributors were coming, many municipalities have failed to maintain their distribution networks or replace skilled technicians. Deteriorating infrastructure and capability has led to increasing power failures, even in larger municipalities like Johannesburg. Moreover, municipalities have often set local tariffs according to financial need rather than to facilitate growth and development. The result has been that there is a huge differential in prices and service levels among municipalities, with the poorest municipalities charging the highest prices.

#### Municipal and Public Finance Law

10. (SBU) As government authorities are discovering, creating REDs based on municipal law creates a number of problems of its own. Municipal law stipulates that 1) municipalities must control 51% of the shares in any joint venture formed, 2) may not make foreign loans 3) must adhere to a cap on salaries for senior staff, and 4) must follow certain procedures to obtain approval for capital expenditures. Both EDI CEO Nzimande and ESKOM's Skinner pointed out to us that municipal law could hamstring future RED operations, because it does not allow for the REDs to make quick decisions, hire highly skilled staff, or easily acquire advanced equipment. They want to find a way to incorporate the REDs as state owned enterprises so that they may more freely operate as independent, competing public corporations, unencumbered by the legal and fiscal constraints normally imposed on local government.

11. (SBU) As it stands now, municipalities have the constitutional right to opt out of the REDs scheme. They can continue to distribute electricity even after a regional electricity distributor is established. Eskom would still be legally bound to supply electricity to them. This makes the whole scheme voluntary, and strengthens the negotiating hand of the municipalities.

12. (SBU) According to EDI's Nzimande, government will continue to solicit the voluntary incorporation of municipalities in REDs, using economic and commercial benefits to persuade them to join. She said that government was determined that restructuring take place, and would resort to political persuasion (the ruling ANC party controls most municipal councils today) and even amendments to the municipal law, if need be. No one is talking about amending the Constitution at this time, since regional electricity distribution does not warrant the opening of Pandora's Box on other constitutional questions.

## Next Steps

-----

13. (SBU) The Government knows that it has to finalize a number of operational and commercial issues before it can implement its RED scheme. These include: the ringfencing from a municipal budget point view of municipal services from electricity distribution, compensation to municipalities for the loss of electricity revenues, compensation to Eskom and municipalities for the transfer of assets to the REDs, RED ownership and how to share RED revenues among owners, Eskom's role (Eskom currently supplies directly to some 150 large users such as the mines and plants), the National Energy Regulator's (NER) role in determining tariffs, and how to manage competition between the REDs and Eskom. The Electricity Regulation Bill, due in Parliament at the end of August, may be the first legislative opportunity to resolve some of these issues.

FRAZER